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E.O. 12958: N/A
TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICAN RESERVE BANK (SARB) SEPTEMBER 2004 QUARTERLY BULLETIN

SUMMARY

¶1. Summary. The September 2004 South African Reserve Bank's (SARB) quarterly bulletin reported mostly positive developments in South Africa's macroeconomic indicators for the second quarter of 2004. Real gross domestic product (GDP) growth continued its over 3 percent growth, reaching 3.9 percent compared to 3.6 percent in the first quarter 2004. South Africa's real GDP has now expanded for 23 consecutive quarters. Real household consumption increased by 4.3 percent. Fixed capital formation grew by 10.4 percent, led by a 53.8 percent increase in public corporation investment that accounted for 59 percent of the quarterly change. Private sector investment also showed strong growth, increasing by 5.4 percent, led by mining (especially platinum), agricultural and manufacturing sectors. After 22 years of consecutive quarterly trade surpluses, South Africa's trade balance reached a R5.5 billion deficit. As global growth recovered in the first half of 2004, the export sector grew 42.3 percent (q/q) after two consecutive quarters of over 9 percent declines; a 95.3 percent quarterly growth in imports, however, restrained overall GDP growth. End Summary

INTRODUCTION

¶2. The September 2004 SARB's quarterly bulletin includes data and commentary about the South African economy up to the end of the second quarter 2004. This cable summarizes bulletin highlights. The full quarterly bulletin is available at www.resbank.co.za

GDP GROWTH RECOVERS - DOMESTIC EXPENDITURES GROWTH REMAINS HIGH
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¶3. Real gross domestic product (GDP) growth continued its over 3 percent growth in the second quarter 2004, reaching 3.9 percent compared to 3.6 percent in the first quarter 2004. South Africa's real GDP has now expanded for 23 consecutive quarters, fueled mainly by a 13 percent increase in gross domestic expenditures (GDE) and significantly higher than the 2004 Q1's increase of 2.9 percent. A 13.6 percent increase in inventories, compared to first quarter's rise of 3.1 percent, explains the much higher increase in GDE during the second quarter. Domestic demand (excluding inventories) remained strong, increasing 5.3 percent, as interest rates continued their downward trend. Real household consumption continues to grow higher than GDP, at 4.3 percent compared to last quarter's 4.9 percent. Real capital formation increased 10.4 percent after first quarter's growth of 14.6 percent. Capital formation by public corporations contributed 59 percent of the second quarter's change, while private investment accounted for 39 percent. Increased global growth countered the trade-weighted rand strength resulting in a 42.3 percent quarterly export growth; however, a 95.5 percent import growth caused the current account deficit to reach 3.8 percent of GDP.

¶4. Real household consumption increased by 4.3 percent in the second quarter, slightly lower than 4.9 percent in Q1. Growth in household spending on durable goods reflected a slowdown in Q2 growth of 9 percent compared to Q1 growth of 12 percent. Furniture and household appliances experienced the sharpest slowdown in Q2 growth. Growth in real disposable income slowed to 3.8 percent growth in the second quarter, compared to the first quarter's 5 percent growth. Household debt as a percent of disposable income rose slightly to 54.8 percent (compared to 54 percent last quarter), as consumer spending on durable goods was financed by less

expensive credit. Government consumption rose by 3.8 percent in the second quarter, lower than first quarter's 4.6 percent growth.

¶5. During Q2, fixed capital formation grew by 10.4 percent, led by a 53.8 percent increase in public corporation investment that accounted for 59 percent of the quarterly change. Private sector investment also showed strong growth, increasing by 5.4 percent, led by mining (especially platinum), agricultural and manufacturing sectors. Inventories showed especially strong growth in the second quarter rising to 13.6 percent compared to first quarter's 3.1 percent growth, with most of the inventory growth occurring in the manufacturing sector.

SECOND QUARTER TRADE BALANCE TURNS NEGATIVE

¶6. After 22 years of consecutive quarterly trade surpluses, South Africa's trade balance reached a R5.5 billion deficit. (Note: trade balance defined as merchandise exports plus net gold exports minus merchandise imports Endnote) The current account deficit (trade balance adjusted for net service, income, and current transfer payments) widened to R49.3 billion, reaching 3.8 percent of GDP. However, if imports of oil, aircraft and naval ships were excluded, then the current account deficit would be closer to 1 percent of GDP. The net inward flow of capital continued in the second quarter with R25.9 billion, primarily due to large increases in portfolio investment. Inflows of foreign direct investment, which had been small but positive since last year, declined in the second quarter to a deficit of R1.8 billion compared to first quarter's surplus of R7.8 billion. The drop in foreign direct investment was due to the sale of half of its Telkom shares by foreign equity partner Thintana in June.

EXPORTS IMPROVE BUT IMPORTS OVERWHELM

¶7. As global growth recovered in the first half of 2004, the export sector grew 42.3 percent (q/q) after two consecutive quarters of over 9 percent declines. However a 95.3 percent quarterly growth in imports restrained overall GDP growth. Second quarter real merchandise exports increased 12.6 percent compared to a 3.6 percent decline during the first quarter. However a 20.5 percent increase in real merchandise imports, due to sharp increases in oil and military equipment, explains the turnaround in the current account trade balance. Between March 31 and June 20 2004, the weighted average rand exchange rate, calculated with reference to a basket of 13 currencies, appreciated 2.4 percent, compared to 5.7 appreciation between December 31 2003 and March 31 2004, and 11 percent appreciation over the first quarter of 2003. The South African Reserve Bank continues to build foreign reserves, hoping to reduce volatility in the rand exchange rate. The country's net international reserves rose by R12.1 billion during Q2, following an increase of R13.4 billion in Q1. The SARB's foreign reserves increased from USD 9.8 billion at the end of March to USD 11.9 at the end of August.

INFLATION AND MONEY SUPPLY ON COURSE

¶8. During the second quarter, money supply (M3) increased by 13.3 percent, with overall consumer prices increasing by 2.3 percent. Consumer price inflation, excluding mortgage costs (CPIX), increased by 5.4 percent, within the Reserve Bank's target range of 3 to 6 percent. Falling import prices caused by the strong rand was the main reason for consumer prices tracking downwards. Unit labor costs increased 5.9 percent (q/q) just within the inflation target. Both average nominal and real wages increased (9.4 percent and 5.1 percent respectively). Labor productivity increased 3.3 percent.

COMMENT

¶9. Strong growth in both domestic investment and consumption has improved short-term South African growth. Rising global demand is fueling growth in manufacturing and mining but the expansion of those sectors will have to rely on continued global growth in order to overcome the negative impact of a strong rand. The latest government forecast for growth is 2.9 percent in 2004 and rising to 3.6 percent in 2005 (note: Budget Review 2004). The 2004 Medium Term

Policy Statement to be presented to Parliament at the end of October will probably revise government economic growth forecasts. While most private economic forecasters expect 2004 growth at 3 percent, the recent Quarterly Bulletin may point to some problems in achieving future growth over 3 percent during the next two quarters. Both investment and consumption show over 4 percent growth in the second quarter, though their growth has stabilized. In order to sustain higher GDP growth, South African exports should increase in the face of higher world global demand growth. South Africa has to rely on strong commodity prices and global demand so that exports can be the future engine of growth. Recent improvements in labor productivity can be attributed to a 1.7 percent decline in employment, not the best way to increase domestic demand. Second quarter foreign direct investment outflows will not help in attaining the government's stated foreign direct investment inflows of 2 percent of GDP. Deteriorating current account deficits may put pressure on the rand to depreciate; combined with higher oil prices this may lead to higher inflation and possibly interest rate increases. Inflation prospects for 2004 will depend on food prices, wage negotiations, oil prices and the rand. The impact on targeted inflation will steer the South African Reserve Bank's actions in setting interest rates. End comment.

FRAZER